Exhibit F

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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Petition of ACS of Anchorage, Inc. Pursuant to	)	
Section 10 of the Communications Act of 1934, as	)	WC Docket No. 05-281
amended, for Forbearance from Sections 251(c)(3)	)	
and 252(d)(1) in the Anchorage LEC Study Area	)	
	)	

REPLY STATEMENT OF DAVID C. BLESSING IN SUPPORT OF PETITION OF ACS OF ANCHORAGE, INC. FOR FORBEARANCE FROM SECTIONS 251(C)(3) AND 252(D)(1)

1. My name is David C. Blessing. I am a principal in the consulting firm of Parrish, Blessing & Associates, Inc. The purpose of this statement is to respond to the economic feasibility analysis described by General Communication, Inc. ("GCI") in its opposition to the petition of ACS of Anchorage, Inc. ("ACS") for forbearance from Sections 251(c)(3) and 252(d)(1) of the Communications Act of 1934.

Summary

2. As part of its opposition, GCI presents an "economic feasibility" analysis by William P. Zarakas that allegedly shows the number of current lines and circuits currently served by GCI that can be "economically served" using GCI's own facilities.[1]

[1] Declaration of William P. Zarakas, *Opposition of General Communication, Inc. to the Petition for Forbearance from Sections 251(c)(3) and 252(d)(1) of the Communications Act Filed by ACS of Anchorage*, WC Docket No. 05-281, attached thereto as Exhibit C ("Zarakas Decl.").

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GCI concludes from this analysis that allowing ACS relief from certain UNE obligations will be harmful to competition in the Anchorage market.[2]

3. In this statement I will demonstrate that Mr. Zarakas's analysis contains a number of serious flaws that dramatically overstate GCI's cost of serving its existing retail customers entirely over its own facilities. Further, the findings cannot be verified because Mr. Zarakas fails to provide the necessary details of his analysis. For example, Mr. Zarakas fails to identify any of the empirical assumptions used in the model. In light of these deficiencies, the Commission should not give any weight to GCI's claims regarding the results of the analysis. Nevertheless, even with these flaws, Mr. Zarakas's analysis supports ACS's position that the level of facilities-based competition in Anchorage warrants the elimination of certain UNE obligations as requested in the Petition. Correcting the methodology only strengthens the conclusion that granting forbearance will not harm competition in Anchorage.

Accepting all of Mr. Zarakas's assumptions, GCI's own economic feasibility analysis shows that it is capable of serving most customers without access to UNEs.

4. The economic feasibility study presented by Mr. Zarakas yields the following results:

a. **[BEGIN CONFIDENTIAL] [END CONFIDENTIAL]** of GCI's current retail switched residential lines may be served "economically"[3] on GCI's own facilities.[4]

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[2] *Opposition of General Communication, Inc. to the Petition for Forbearance from Sections 251(c)(3) and 252(d)(1) of the Communications Act Filed by ACS of Anchorage,* WC Docket No. 05-281, at 19 ("GCI Opposition").

[3] Mr. Zarakas uses the phrase "economically served" throughout his statement to denote the cases in which the economic feasibility analysis yields a positive net present value (NPV).

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b. **[BEGIN CONFIDENTIAL] [END CONFIDENTIAL]** of GCI's current retail switched small business lines may be served "economically" on GCI's own facilities.[5]

c. **[BEGIN CONFIDENTIAL] [END CONFIDENTIAL]** of GCI's current retail switched medium and large business lines may be served "economically" on GCI's own facilities.[6]

d. **[BEGIN CONFIDENTIAL] [END CONFIDENTIAL]** of GCI's current total retail switched lines may be served "economically" on GCI's own facilities.[7]

e. **[BEGIN CONFIDENTIAL] [END CONFIDENTIAL]** of GCI's current non-switched circuits may be served "economically" on GCI's own facilities.[8]

5. These results demonstrate that GCI is not dependent upon ACS UNEs to compete effectively in the Anchorage market. Even based on a flawed methodology, Mr. Zarakas's analysis shows that, for all but the small business switched segment, there does not seem to be any significant customer base GCI cannot serve using its own facilities. In what is considered to be the most profitable market segment—medium and large business—it would be able to economically serve almost **[BEGIN CONFIDENTIAL] [END CONFIDENTIAL]** of its current customers on its own facilities. In addition, Mr. Zarakas's analysis does not include customers currently subscribed to ACS retail services that GCI easily could serve over its own facilities. For example, in the residential

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[4] Zarakas Decl. at Exhibit I.

[5] *Id.*

[6] *Id.*

[7] *Id.*

[8] *Id.* at Exhibit II.

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segment, GCI reports that it can economically serve **[BEGIN CONFIDENTIAL] [END CONFIDENTIAL]** of its current retail customers. Since ACS serves a number of residential lines almost equal to that GCI serves, it is likely that GCI would be able to economically serve on its own facilities close to **[BEGIN CONFIDENTIAL] [END CONFIDENTIAL]** of the current ACS lines. Consequently, even according to Mr. Zarakas's analysis, GCI has the ability to expand the number of retail lines from its current total.

GCI's feasibility analysis contains several faulty assumptions, and consequently significantly overstates the cost of providing service to new customers.

6. Although Mr. Zarakas does not explicitly describe the methodology used to determine the "economic feasibility" of upgrading GCI's present facilities or building additional facilities, Mr. Zarakas's statement reveals the following regarding the methodology used:

a. "Economic feasibility," as used by Mr. Zarakas, is found when the discounted cash flow of upgrading existing facilities or building new facilities is positive. This type of analysis calculates the present value of net cash flows over the study period.[9]

b. The discounted cash flow analysis assumes 15 years of cash flows.[10]

c. The analysis assumes that a digital local phone service solution over existing cable plant will be used to provide residential and business switched services. Non-switched services for GCI's medium and large business customers are assumed to be provided by extending GCI's existing fiber facilities.[11]

[9] *See id.* at ¶ 20 & n.17.

[10] *Id.* at ¶ 20 n.16.

[11] *See id.* at ¶¶ 22-24.

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d. The feasibility study looks only at lines, circuits and customers already served by GCI on a retail basis. It does not include those items currently subscribed to ACS retail.[12]

e. The discounted cash flow analysis uses only those retail revenues associated with providing local exchange services, including any applicable universal service support.[13]

f. The analysis includes only those incremental capital expenditures associated with upgrading GCI's existing cable plant and extending GCI's current fiber facilities.[14]

g. A discount rate of 8.5% is used in the present value calculation.[15]

7. The major flaw of Mr. Zarakas's analysis is that he did not provide the model he used or its underlying assumptions. Without this information neither the Commission nor anyone else can rely on the model's results. Further, the absence of the model makes it impossible to restate the results after correcting for those flaws that can be identified from what GCI has provided. Based on the information we do know from Zarakas's declarations, his model suffers from the following flaws:

a. **Forecast error for outyear cash flow**

Net present value ("NPV") analyses are a traditional approach used to prove-in capital projects or business plans. However, they suffer from the same problem as most forward-looking models. As the number of years used in the

[12] *See id.* at ¶ 20.

[13] *See id.* at ¶ 25.

[14] *See id.* at ¶ 26.

[15] *Id.* at ¶ 30.

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study period increases, so too does the amount of uncertainly about future net cash flows. The GCI study uses a 15-year study period, which means that it is necessary to estimate the level of revenues and costs associated with cable telephony build-out for each of the 15 years. This requires assumptions about retail price changes, technology changes and demand changes. Without seeing Mr. Zarakas's model and its underlying assumptions, it is impossible to identify and evaluate these assumed changes. However, it is indisputable that there is a large degree of uncertainty inherent in this type of analysis. It is unlikely that retail prices will stay constant and it is near certain that technological changes will alter the investment and operating costs of building out a network.

Mr. Zarakas also appears to assume that GCI's demand level will not change. This is an exceedingly weak assumption given how fast GCI gained a majority market share in the Anchorage market. Mr. Zarakas's model relies on the assumption that he can, with a fair degree of accuracy, estimate net cash flows over the next 15 years. Given the dynamic nature of the industry and the local market, there is a low probability that his cash flow assumptions are even relatively accurate.

b. **Only local revenues are used in the cash flow calculation**

GCI's model understates net cash flow because it only includes local exchange revenues and universal service support. The exclusion of intrastate toll revenues, interstate access and long-distance revenues, and revenues from

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packages that bundle cable, long-distance and wireless services with local exchange services significantly understates the actual per customer revenue GCI or any local carrier receives.[16] Even under the extreme assumption that a customer makes no toll or long-distance calls, revenue would increase by the amount of the Subscriber Line Charge ("SLC") and recently adopted state Network Access Fee ("NAF").[17] Those customers currently subscribed to GCI bundles also present a problem. Mr. Zarakas does not explain how the bundle revenues are allocated between telephone, cable, wireless and long distance services.

The underlying assumption of Mr. Zarakas's analysis is that, with the elimination of certain of ACS's UNE obligations, GCI would no longer be able serve customers where the NPV calculated under this analysis is negative. A more informative NPV methodology would be comparing the total revenue of the bundle to the cost of providing all the services in the bundle—including the

[16] GCI itself recognizes the need to perform comprehensive financial evaluations. In a recent state proceeding to consider a Petition for Suspension and Modification submitted by the Matanuska Telephone Association ("MTA"), GCI stated, "But the biggest failure, the biggest single failure with the LRF model is it doesn't account for all of MTA. They made much of the fact that the Eighth Circuit requires you to examine all the burdens, but, boy, we don't want you to see the integrated company with all of the benefits that led to and can mitigate those burdens. It completely excludes the non-regulated subsidiary operations of MTA which account for fully 20 percent of their revenues." Public Hearing, Regulatory Commission of Alaska, Docket U-05-46, Opening Statement of GCI, Tr. Vol. III at 164-165 (October 24, 2005).

[17] For multiline business customers the SLC is $9.20 per month. For residential and small business customers the SLC is $6.50 per month. The state NAF is $1.50 per connection, increasing to $3.00 on April 1, 2007.

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investment associated with expanding the GCI network. By including only local service revenue, presumably just a partial allocation of the bundle price, Mr. Zarakas likely severely understates the NPV of serving the customer.

c. **A negative NPV for a portion of retail customers does not speak to whether GCI would still be profitable in the aggregate if it served all customers on its own facilities**

Mr. Zarakas's model uses an incremental approach to evaluate build-out projects. As a result, his analysis does not provide an answer to the central question whether GCI would be profitable *in the aggregate* serving all of its customers on its own facilities. GCI, ACS and all other telecommunications carriers are more profitable in certain areas within their territories than in other areas. It costs ACS more to serve some locations in Anchorage than it does to serve others and the average revenue per customer often varies by area. Consequently, the net cash flow will vary by area within Anchorage. In a relatively high-cost area with a relatively low average revenue per customer, negative net cash flow would be expected. However, that does not mean that GCI is not profitable in Anchorage or that GCI should not be expected to serve areas with negative cash flow. The addition of customers in these areas helps to reduce the per line share of overhead and fixed cost recovery for other customers and increases the net cash flow of the other areas as well. Thus, as long as the entire territory is profitable, all areas are viable for GCI to serve.

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Mr. Zarakas's analysis supposedly demonstrates that it would not be profitable (as measured by positive net cash flow) to serve certain GCI's customers on its own facilities. Regardless of whether this assertion is valid on a customer-by-customer basis, it does not address whether serving the entire customer base on its own facilities would allow GCI to recover its costs and still earn a reasonable return on investment. The fact that even GCI claims it can economically serve **[BEGIN CONFIDENTIAL] [END CONFIDENTIAL]** of its current switched lines and **[BEGIN CONFIDENTIAL] [END CONFIDENTIAL]** of its current dedicated circuits profitably indicates the market in the aggregate is likely to be profitable for GCI.[18]

d. **GCI is unwilling to shoulder any investment risk**

As discussed above, the Zarakas analysis evaluates a static state—there is no recognition of changes in demand, technology and/or market price. GCI appears to be taking the position that, unless customers can be economically served as determined by using the demand, technology and market prices that exist today, GCI is not going to invest in additional facilities. Put in different words, GCI is not willing to take on any investment risk. The company wants to earn a profitable return while allowing ACS to bear all the risk of investment loss. Under such a scenario, it would be more reasonable for Mr. Zarakas to use a

[18] Zarakas Decl. at Exhibits I, II.

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discount rate equivalent to the 10-year treasury yield of 4.6%[19] rather than the 8.5% risk-free rate his model now employs. Due to the lack of transparency in Zarakas's calculation, there is no meaningful way to estimate the impact on the NPV of using a lower discount rate. However, a reduction in the discount rate certainly would further increase NPV and significantly reduce the number of customers that GCI would find not economical to serve.

e. **GCI's claim that it is not economical to incrementally build out its network for a portion of the customers currently served on ACS facilities has disturbing implications for the UNE loop rate in Anchorage**

If UNE rates represented the true forward-looking of cost of building plant then GCI would be indifferent to leasing UNEs from ACS or building its own plant. The issue would boil down to allowing GCI to have UNEs at TELRIC prices for the period of time GCI needed to fully build out its network. GCI believes that it is financially less viable to build out its own facilities to all customers than to use ACS UNEs.[20] In parts of the study area where customers are more costly to serve, GCI's assessment is most certainly true because TELRIC rates are based on costs averaged over the entire study area. As discussed above, by taking an incremental approach to economic feasibility, GCI gets the benefit of leasing UNEs on averaged prices in high cost areas. However, UNEs were never intended to be used to provide a subsidy to CLECs, nor to insulate them from the normal risk of competitive entry, including capital costs

[19] *Late Surge Pushes Dow to 41/2-Year High*, WASH. POST, Feb. 17, 2006, at D3.

[20] GCI Opposition at 19.

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associated with investment in this market. Mr. Zarakas's analysis suggests that UNEs are priced at below market levels. Thus, continued mandatory unbundling is stifling facilities investment by GCI.

8. GCI's economic feasibility analysis does not support its argument that eliminating certain ACS unbundling obligations will be harmful to competition in Anchorage. Even disregarding the numerous flaws which cause significant understatement of net cash flow, Mr. Zarakas's analysis shows that GCI can economically serve **[BEGIN CONFIDENTIAL] [END CONFIDENTIAL]** of its switched lines and **[BEGIN CONFIDENTIAL] [END CONFIDENTIAL]** of its dedicated circuits. Correcting the flaws in the model only increases these percentages. Mr. Zarakas's analysis strengthens ACS's position that the elimination of certain ACS UNE obligations will not harm competition and provides evidence that forbearance will not eliminate GCI's profits. Without UNE regulation, GCI will have the incentive to further invest in its own network to benefit of consumers in Anchorage.

Respectfully Submitted,

/s/ David C. Blessing

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